BEFORE THE
CALIFORNIA BOARD OF ACCOUNTANCY
DEPARTMENT OF CONSUMER AFFAIRS
STATE OF CALIFORNIA

In the Matter of the Accusation Against: GREGG WAYNE RITCHIE, Certified Public Accountant License No. 31490 Respondent.	Case No. AC-2010-10 OAH No. 2010040960

DECISION

The attached Proposed Decision of the Administrative Law Judge is hereby adopted by the California Board of Accountancy as the Decision in the above-entitled matter.

This Decision shall become effective on April 28, 2012.

IT IS SO ORDERED March 29, 2012.

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PROPOSED DECISION

Administrative Law Judge David L. Benjamin, State of California, Office of Administrative Hearings, heard this matter in Oakland, California, on July 18-22, August 1-5, 8-10, and 11, and September 7, 26-27, 2011.

Supervising Deputy Attorney General Diann Sokoloff represented complainant Patti Bowers, Executive Officer of the California Board of Accountancy, Department of Consumer Affairs.

Cristina C. Arguedas, Attorney at Law, Arguedas, Cassman & Headley LLP, and Michael W. Anderson, Attorney at Law, Law Office of Michael Anderson, represented respondent Gregg Wayne Ritchie, who was present on all days of hearing except July 20-22, August 5 and 8, and September 7.

The record was held open to receive written argument, which was timely filed. Complainant's opening brief was marked for identification as Exhibit 226; respondent's brief was marked for identification as Exhibit 901; and complainant's reply brief, filed on January 17, 2012, was marked for identification as Exhibit 227. The record was closed and the matter was submitted for the first time on January 17, 2012.

The record was reopened on January 27, 2012, to receive a letter from complainant bearing the same date, enclosing a United States Tax Court decision in the case of *Blum v. Commissioner*; these documents were marked for identification collectively as Exhibit 228. Respondent's reply was filed on January 31, 2012, and marked for identification as Exhibit 902. The record was closed for the second time on January 31, 2012, and the matter was deemed resubmitted on that date.

After the record closed for the second time, complainant submitted further written argument (marked for identification as Exhibit 229) with the request that the record be reopened once again to receive it. Complainant's request was denied, Exhibit 229 was excluded, and the record remained closed.

SUMMARY

Between 1996 and 1999, KPMG marketed three tax products, called FLIP, OPIS and BLIPS. These products were sold to high net worth individuals who needed to generate tax losses to offset capital gains. The Internal Revenue Service has since determined that all three products were abusive tax shelters that do not comply with tax laws; the courts have found that BLIPS losses are not allowable under the tax laws; and other participants in the transactions, notably KPMG itself and an investment advisor affiliated with KPMG, have admitted that the transactions were fraudulent.

Respondent was a partner in KPMG's tax department when FLIP was implemented and sold, and when OPIS was developed. After he left KPMG in 1998, respondent entered into two BLIPS transactions, one on behalf of his employer and one on his own account. In this proceeding, complainant seeks to discipline respondent on the ground that he engaged in fraud, dishonesty, violations of professional standards and other wrongful conduct in connection with all three tax products. Respondent denies any wrongdoing. He asserts that the products were created by tax specialists at KPMG, whose expertise and judgment he relied on, and that he always believed in good faith in the validity of the three products.

The evidence establishes that respondent signed opinions in which he advised clients that a FLIP transaction was "more likely than not" to be upheld by the Internal Revenue Service, when he knew that if all the facts were disclosed to the IRS, the transaction would not be upheld. Respondent played a key role in bringing OPIS to market when he knew, if all the facts were disclosed to the IRS, the transaction would not be upheld. Respondent took steps to conceal the true nature of FLIP and OPIS from the IRS. The evidence does not establish wrongdoing by respondent with respect to BLIPS.

FACTUAL FINDINGS

Background

1. On January 30, 1981, the California Board of Accountancy (board) issued Certified Public Accountant Number CPA 31490 to respondent Gregg Wayne Ritchie. The license was in full force and effect at all times relevant to the matters at issue in this case, and will expire on February 28, 2013, unless renewed.

2. On November 17, 2009, complainant Patti Bowers, acting in her official capacity as Executive Officer of the board, issued an accusation against respondent. Respondent filed a notice of defense. On June 9, 2011, complainant issued an amended

accusation, the pleading on which the case was heard. The amended accusation was amended further at hearing.

Respondent

3. Respondent is 54 years old. He and his wife have two adult children.

Respondent started work at KPMG in 1977, as an intern in the firm's tax department. Respondent was as an undergraduate at the University of Southern California, majoring in business administration with an emphasis in accounting. At that time, KPMG – known then as Peat Marwick Mitchell – was one of the "Big Eight" accounting firms, with offices throughout the country and various departments staffed by specialists in particular areas. (KPMG is now one of the "Big Four" accounting firms.) When he graduated from college, where he was first in his accounting class, respondent was hired into KPMG's tax department in its Los Angeles office; he later moved to KPMG's Woodland Hills office, where he spent the remainder of his career with the firm. Respondent started doing individual tax returns, and progressed to the point that he was assigned to Union Bank and then to the Coldwell Banks Institutional Funds, large commercial accounts with very complicated tax issues. Respondent was made partner – by unanimous vote, a rare accomplishment – at the age of 30 after just nine years at the firm; the tax department generally requires 12 or 13 years of experience. As a tax partner, respondent represented wealthy, high net worth individuals who were executives in large businesses, or who owned their own businesses. As a partner, respondent shared in the profits of the firm. He resigned from KPMG, after spending over 22 years in its tax department, effective September 30, 1998.

Since he left KPMG, respondent has been the chief financial officer and managing director of Pacific Capital Group, a private investment banking firm.

When he testified in August 2011, respondent stated that he had not practiced public accounting for 13 years. Respondent's testimony is understood to mean that he has not practiced since he left KPMG.

FLIP and OPIS

4. In the 1990's, in addition to providing advice and audit services, KPMG developed packaged tax "products" that it sold to clients for a fee. Other large accounting firms also sold tax products and competed in that market with KPMG.

5. In mid-1996, John Larson, a tax partner at KPMG, decided that the firm needed a "capital loss transaction" that it could market to high net worth individuals who had realized large capital gains – by selling a company, for example – and who needed to generate losses to reduce their taxes. Based on a 1995 corporate transaction involving Seagrams and DuPont, KPMG developed its "Foreign Leveraged Investment Program," known as "FLIP." A FLIP transaction involved a complicated, predetermined series of

financial transactions between KPMG's client, who was a United States individual taxpayer, a foreign bank, and a foreign corporation.[1] KPMG used the services of an investment advisory firm to create the foreign corporation necessary for the transaction, and to develop the necessary legal instruments. The foreign corporation was a paper corporation with no employees, established in the Cayman Islands by the investment advisory firm for the purpose of implementing the FLIP transaction.

6. In a PowerPoint presentation to its salespersons, KPMG described the six steps of a FLIP transaction, and the timing for the execution of those steps. The example in the PowerPoint is for a transaction in which the "goal" is a "10M Capital Loss."

The PowerPoint identifies three steps that would occur on "Day 1" of the transaction:

Step 1: U.S. Person purchases options for 90% of SPV [2] for $700K (Cost 7.0% of $10M)

Step 2: U.S. Person purchases Foreign Bank shares for $500K (cost 5% of $10M)

Step 3: SPV purchases $10M shares of Foreign Bank

Steps 4 and 5 were to occur on "Day 46":

Step 4: Foreign Bank redeems shares held by SPV for $10M (assumes no market fluctuation)

Step 5: Simultaneous with Step 4, U.S. Person purchases out of the money call options to acquire $10M shares of Foreign Bank for $100K (cost 1% of $10M)

On the 90th day or later, Step 6 would occur:

Step 6: U.S. Person sells Foreign Bank Shares and Options to trigger capital losses.

7. Although FLIP was marketed as having an investment component, its real purpose was to generate large tax losses for KPMG's clients. Clients calculated the tax loss

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[1] Coordinated Issue Paper No. 9300.18-00, issued by the Commissioner of the IRS, describes how a typical FLIP/OPIS transaction worked, and the legal arguments advanced by KPMG to justify the losses generated by the transactions. The description is too long to quote here.

[2] "Special Purpose Vehicle," i.e., the Cayman Islands corporation.

they wanted to achieve in a given tax year, and paid a fee for the transaction that was based on a percentage of the expected tax losses; the typical fee was about seven percent of the expected tax loss. KPMG clients could – and did – pay fees of approximately $700,000 to participate in a FLIP transaction that would generate approximately $10,000,000 in "losses" that the clients would claim on their income tax returns. In these transactions, the client did not in fact lose $10,000,000 or any amount close to that.

8. As part of what KPMG referred to as its "toolkit" for a FLIP transaction, it developed four documents to be used in every FLIP transaction.

KPMG would not make a presentation concerning the FLIP product until the client or potential client signed a non-disclosure agreement (NDA); if the potential client wanted to involve his or her own legal or financial experts, they, too, were required to sign an NDA. The NDA described FLIP as a "proprietary structure" of KPMG. NDA's were not commonly used by KPMG at that time.

A client who decided to entered into a FLIP transaction signed an engagement letter, which set forth the terms and conditions of the relationship between the client and KPMG.

The firm prepared a representation letter, in which the client would set forth the facts of his particular FLIP transaction. Since all FLIP transactions were essentially the same, this document was prepared in advance by KPMG, and the details of each transaction were filled in later. KPMG used this document to establish the factual basis for its opinion letter. KPMG would not issue an opinion letter without the client's representation letter.[3]

And KPMG developed an opinion letter. The opinion letter was a critical element of a FLIP transaction. If the Internal Revenue Service were to disallow the taxpayer's claimed losses, the taxpayer would face significant penalties. Under the tax code at that time, however, the taxpayer could avoid penalties if he or she "reasonably believed that the tax treatment of such item by the taxpayer was more likely than not the proper treatment." (Int.Rev. Code, § 6662(d)(2)(C)(i)(II).) Thus, an opinion from KPMG, stating that its proposed tax treatment was "more likely than not" the proper treatment, was seen as essential to protect the taxpayer from penalties. To protect the taxpayer, a more-likely-than-not opinion letter had to be based on all the facts and circumstances of the transaction. (Treas. Reg. §1.6664-4(c)(1)(i)-(ii).) It could not be based upon the premise that material facts and circumstances would be concealed from the IRS.

[3] KPMG client Joseph Jacoboni entered into a FLIP transaction in 1997. In his words, he "invested" $2.4 million for an anticipated tax loss of about $28 million. After the transaction was completed, Jacoboni refused to sign the representation letter on the ground that he did not understand it. The tax partner handling Jacoboni's account referred Jacoboni to respondent. In a telephone conference with Jacoboni and Jacoboni's attorney, respondent informed them that without a representation letter, KPMG could not issue an opinion letter. After consulting with his own legal and tax experts, Jacoboni signed the representation letter.

9. About 50 tax experts at KPMG, many of whom had worked for the United States Treasury Department and the IRS, developed what the firm referred to as a "generic" written opinion to use in all FLIP transactions. Since all FLIP transactions were the same, except for the names of the parties and the financial data, the opinion letter used in each transaction was the same in all material respects.

The opinion, which was over 70 pages long, addressed the various legal doctrines that the IRS might invoke to invalidate the losses.

One such doctrine was the "step transaction doctrine." This doctrine is "a corollary of the general tax principle that . . . taxation depends on the substance of a transaction rather than its form." (*Security Indus. Ins. Co. v. United States* (5th Cir. 1983) 702 F.2d 1234, 1244.) Under the step transaction doctrine,

> [i]nterrelated yet formally distinct steps in an integrated transaction may not be considered independently of the overall transaction. By thus "linking together all interdependent steps with legal or business significance, rather than taking them in isolation," federal tax liability may be based "on a realistic view of the entire transaction." [Citation omitted.]

(*Commissioner v. Clark* (1989) 489 U.S. 726, 738.) The risk to a FLIP client was that, instead of viewing each of the various transactions as independent transactions with their own business significance, the IRS would ignore the intermediate steps and view it all as one transaction for the purpose of generating improper losses. The KPMG opinion concluded that it was more likely than not that the transaction would survive application of the step transaction doctrine.

Another doctrine addressed by KPMG's opinion was the "economic substance doctrine." This doctrine "has been used to prevent taxpayers from subverting the legislative purpose of the tax code by engaging in transactions that are fictitious or lack economic reality simply to reap a tax benefit." (*Coltec Industries, Inc. v. United States* (Fed. Cir. 2006) 454 F.3d 1340, 1353-1354.)

> The economic substance doctrine seeks to distinguish between structuring a real transaction in a particular way to obtain a tax benefit, which is legitimate, and *creating* a transaction to generate a tax benefit, which is illegitimate. [Citations omitted; original emphasis.] Under this doctrine, we disregard the tax consequences of transactions that comply with the literal terms of the tax code, but nonetheless lack "economic reality." [Citations omitted.]

(*Stobie Creek Investments LLC v. United States* (Fed. Cir. 2010) 608 F.3d 1366, 1375.)

If the IRS determined that a FLIP transaction had no economic effect other than the creation of tax losses, the taxpayer's losses could be disallowed. The KPMG opinion concluded that it was more likely than not that FLIP would satisfy the economic substance doctrine.

10. In the fall of 1996, the KPMG partners who had developed FLIP, Larson and Robert Pfaff, brought respondent in to "head the effort." Respondent was well-situated in the firm for the assignment. He worked in the firm's Personal Financial Planning division, which serviced wealthy executives and families that owned their own businesses; these clients were selling their businesses at a high rate and were looking for ways to reduce their capital gains. Respondent had also created a national practice ("Capital Transactions Strategies" or "CaTS") made up of six partners that provided "income . . . tax strategic planning for individual sellers of businesses and other appreciated property." The purpose of CaTS was to "bring a new analytical tool to clients contemplating the sale of assets to assist them in assessing tax risk and potential returns from available strategies."

11. Respondent headed a national transition team, composed of technical tax partners, salespersons, and others, to manage and supervise the sale of FLIP transactions. The team met in Denver on September 3, 1996. After the meeting, respondent wrote to colleagues at KPMG and informed them that the transition team had finalized the relationship with an investment advisory firm; that R. J. Ruble from the law firm of Brown and Wood had agreed to a "preferred version" of FLIP for which he would write concurring more-likely-than-not letters for FLIP transactions; and that "the Firm" had concluded that FLIP transactions did not have to be registered with the IRS. Respondent informed his colleagues that "[a]ccordingly we are not required to notify our clients of the possibility that the strategy may be a tax shelter (with the resulting negative consequences)." When a tax shelter is registered with the IRS, the tax shelter organizer must disclose to the service numerous details about the shelter, including its structure and expected tax benefits.

12. In an email to respondent shortly after the Denver meeting, a KPMG tax partner wrote to respondent, "Perhaps I heard wrong, but I thought the prevailing view was this was probably a tax shelter, but it was believed that we had reasonable cause not to file." Respondent replied, "I heard the same thing, I just don't think we should have alot [*sic*] of that in writing."

13. In his review of his own performance after the end of Fiscal Year 1996-1997, respondent wrote, "I was able to assist in the development and sale of the [FLIP] Program to many clients (my own and those of other partners across the Firm). This strategy has accounted for fee income to the Firm in excess of $7 million." During the time that respondent sold FLIP transactions, KPMG had an incentive salary structure in place.

14. Between Fall 1996 and Fall 1998, respondent sold seven FLIP transactions, each of which generated approximately $10 million dollars in losses. During that time, he signed seven opinion letters in which he advised the client that it was more likely than not

that the transaction would survive application of the step transaction doctrine by the IRS.[4] Respondent's clients were wealthy and financially sophisticated. They had access to independent legal and financial advisors, and some obtained independent advice before entering into the FLIP transaction.

15. At hearing, respondent testified that he "could not say" whether KPMG marketed FLIP as a loss generating strategy. Respondent's testimony on this point was not truthful. Beginning in the fall of 1996, respondent was in charge of marketing FLIP. KPMG's marketing materials demonstrated how a FLIP transaction could generate a $10 million capital loss, and respondent's own FLIP clients claimed losses from the transaction of around $10 million.

16. In Fall 1997, some partners at KPMG expressed concerns about FLIP. One concern was whether the transaction lacked economic substance because the foreign corporation was a paper company. In an email on September 23, 1997, one tax partner wrote, "Obviously, it would also be nice if the Cayman company had at least one employee . . . ."

17. In October 1997, senior tax partner John DeLap expressed his opinion that KPMG should discontinue FLIP. In a conference call on November 11, 1997, in which respondent participated, it was decided that KPMG would stop selling the "current structure" and that it would "walk away from deals unless there's an engagement letter." It was DeLap's opinion that KPMG needed to retire FLIP to "protect the buyers." After November 11, KPMG was working on a new basis-shifting product to replace FLIP, even as it continued to work on FLIP transactions that had already begun.

18. In an email to salespersons and tax partners on November 12, respondent communicated the results of the conference call that was held the day before:

> [Y]ou should be aware that we have decided NOT to pursue the existing [FLIP] strategy as a Firm, effective immediately. This is due primarily to our desire to protect those clients who have entered into the strategy already. YOU SHOULD NOT DISCUSS THE [FLIP] STRATEGY WITH ANY FURTHER CLIENTS OR PROSPECTS. We are working on another strategy which may be appropriate for clients to whom you have already presented the idea. [Original emphasis.]

On the question of how it would protect existing client to stop further sales, respondent testified that he "did not know if we thought that more transactions would make it more likely that the IRS would shut it down." Respondent's testimony on this point was

[4] All of respondent's FLIP opinion letters are dated in December 1997, but respondent acknowledged at hearing that he signed most of the letters much later, including one as late as September 1998.

disingenuous. It is clear from the firm's insistence upon non-disclosure agreements, from the firm's decision not to register FLIP, from respondent's admonition to another partner not to put comments about that decision in writing, and from respondent's own belief that registration would have negative consequences, that both the firm and respondent believed that concealing FLIP from the IRS was important to the product's success.

19. KPMG called its new basis-shifting product "OPIS," for "Offshore Portfolio Investment Strategy." OPIS made minor changes in FLIP, such as changing the structure of the foreign corporation, but it was essentially the same product as FLIP. Like FLIP, it was based on the Seagrams-DuPont transaction, and it used the same basis-shifting strategy that FLIP relied on to generate large losses. As one KPMG partner described it, OPIS was the "son of FLIP." As was the case with FLIP, the firm's OPIS training materials described a series of transactions that would be implemented by the client, with the assistance of KPMG and an investment advisor, in certain steps over a predetermined period of time – in this case, 49 days.

20. At hearing in this proceeding, respondent downplayed his role in the development and implementation of OPIS. At the time, however, respondent identified himself as the "product owner" of OPIS and, in a deposition taken in 2003, respondent testified that it was his job was to "get [OPIS] off the shelf" and "shepherd it." Many different teams in various KPMG offices were involved in the development of OPIS. Respondent coordinated the discussion between the teams at KPMG, the outside attorneys who were to write a concurring more-likely-than-not opinion, and the investment advisory firm, to bring the product to market.

21. As it was developing OPIS, KPMG confronted the issue of whether it was required to register OPIS with the IRS as a tax shelter.

Respondent opposed registration. In a memo to the vice-chair of KPMG's tax department on May 26, 1998, respondent advanced five arguments against registration, including this argument that registration would be inconsistent with the firm's financial interests:

> My conclusions and resulting recommendation are based upon the immediate negative impact on the Firm's strategic initiative to develop a sustainable tax products practice and the long-term implications of establishing a precedent in registering such a product.
>
> **First, the financial exposure to the Firm is minimal**. Based upon our analysis of the applicable penalty sections, we conclude that the penalties would be no greater than $14,000 per $100,000 in KPMG fees. Furthermore, as the size of the deal increases, our exposure to the penalties decreases as a percentage of our fees. For example, our average deal would

result in KPMG fees of $360,000 with a maximum penalty exposure of only $31,000.

[¶] . . . [¶]

Based on the above arguments, it is my recommendation that KPMG does *not* register the OPIS product as a tax shelter. Any financial exposure that may be applicable can easily be dealt with by setting up a reserve against fees collected. Given the relatively nominal amount of such potential penalties, the Firm's financial results should not be affected by this decision.

In summary, I believe that the rewards of a successful marketing of the OPIS product (and the competitive disadvantages which may result from registration) far exceed the financial exposure to penalties that may arise. [Original emphasis.]

Respondent's position was unethical. The decision of whether a tax shelter should be registered with the IRS should be based on the applicable legal principles, not on the financial benefits the firm could realize by refusing to register the shelter. At hearing, respondent testified that he was merely expressing a "downside analysis" of registration. His testimony on this point was not credible, given the recommendation he expressed in his memo.

22. At some time on or before June 4, 1998, KPMG approved OPIS for sale. On June 4, respondent sent an email to various firm personnel in which he stated, in relevant part:

> I am pleased to tell you that the technical conclusions of the OPIS product have been approved by DPP Tax.[5] . . . I encourage you to review the material that Randy [Bickham] gave you at our meeting in Dallas prior to making contact with clients.
>
> [¶] . . . [¶]
>
> You should also note the newest version of the Nondisclosure Agreement . . . . You must ensure that all clients and targets execute this agreement prior to presenting the strategy to them. Furthermore, while we will, under limited circumstances, allow outside advisors to participate in reviewing the strategy, you

[5] The Department of Professional Practice for KPMG's tax practice.

> should only do so with my or Randy Bickham's advance approval. . . . As a general rule, we should strenuously resist sharing this strategy with outside advisors. I am certain that we have a short time frame to market this strategy before legislation will be effective to shut it down. Accordingly, the less publicity, the longer the strategy may be available.

23. Respondent's reference to the "material" distributed by Bickham is to slides that set forth the OPIS "Strategy Overview." Among other things, the slides summarize the transactions that the client and the Cayman company will engage in over a 49-day period.

In an email on June 8, 1998, respondent informed KPMG personnel:

> Please be reminded that you should NOT leave this material with clients or targets under any circumstances. Not only will this unduly harm our ability to keep the product confidential, it will DESTROY any chance the client may have to avoid the step transaction doctrine. [Original emphasis.]

24. At hearing, respondent stated that he did not really think that leaving the slides with clients would affect the client's ability to avoid the step transaction doctrine. He testified that he was only "exaggerating" the consequences of disclosure so that KPMG salespersons would not leave the documents where they might fall into the hands of KPMG competitors. Respondent's testimony is not persuasive. It is true that KPMG viewed FLIP and OPIS as proprietary products, and wanted to maintain their confidentiality from competitors. It is also true, however, that respondent wanted to conceal OPIS from the IRS, just as he wanted to conceal FLIP from the IRS. And it is apparent from respondent's June 8, 1998 email that he was not merely trying to protect KPMG's proprietary interests, as he gave two reasons for keeping the materials confidential: protecting the firm's proprietary interest in the product, and protecting the taxpayer's defense before the IRS. It is concluded that respondent meant what he said in his June 8, 1998 email, namely, that if the slides were not kept confidential, OPIS clients would be unable to survive application of the step transaction doctrine.

25. Respondent resigned his partnership in KPMG effective September 30, 1998. He did not sell any OPIS transactions or issue any OPIS opinion letters. KPMG, however, went on to market OPIS. Together, FLIP and OPIS generated over $4 billion in tax losses.

26. Respondent testified that when he was working for KPMG, he relied on the opinions of the firm's experienced tax specialists to support his belief that FLIP and OPIS were valid under the tax laws. One of respondent's retained experts, Arthur "Kip" Dellinger, a California certified public accountant with almost 50 years of accounting experience, testified that it was proper for respondent to rely on those opinions. The evidence establishes, however, that respondent did not believe FLIP or OPIS was valid. FLIP and

OPIS were essentially the same transaction. Respondent knew that if all the facts concerning these transactions were disclosed to the IRS, the transactions would not be found valid. When respondent signed FLIP opinions in which he advised the client that it was more likely than not that the transaction would survive the step transaction, he knew that was not true. When respondent brought OPIS to market, he knew the transaction would not be upheld if all the facts were disclosed to the IRS.

27. Respondent argues that FLIP and OPIS were in fact valid under the tax laws. To support this argument, respondent relies in part upon the testimony of Dellinger, but primarily on the testimony of Edward McCaffery, a California tax attorney and a professor of tax law at the University of Southern California School of Law. McCaffrey testified that, in his opinion, the tax losses generated by FLIP and OPIS were valid.

28. McCaffery's opinion does not satisfactorily account for respondent's own acknowledgement that the transactions would not be upheld if all the facts were known, nor does it satisfactorily account for the following events:

a. In Notice 2001-45, published on August 13, 2001, the IRS identified basis-shifting strategies like FLIP and OPIS as "listed transactions," that is, tax avoidance transactions that must be reported to the IRS and which, in the IRS's view, subject the taxpayers to various penalties. The IRS announced its intention to challenge the transactions and disallow any claimed losses that arose from the transactions.

b. In October 2002, the IRS announced a settlement initiative for taxpayers who had engaged in FLIP or OPIS transactions. (Announcement 2002-97.) In summary, taxpayers who elected to participate in the settlement initiative prior to December 3, 2002, would be required to concede 80 percent of their claimed losses and would be allowed to keep 20 percent of those losses. Penalties would be waived for any taxpayer who had disclosed the transaction to the IRS prior to April 23, 2002; otherwise, the application of penalties would be determined on a case-by-case basis. Approximately 92 percent of FLIP and OPIS transactions accepted the settlement initiative.

c. In Coordinated Issue Paper No. 9300.18-00, effective December 3, 2002, the Commissioner of the IRS analyzed FLIP and OPIS transactions. The Commissioner concluded that the transactions lack economic substance and business purpose apart from tax savings, and that losses in excess of any money the taxpayer had put at risk would be disallowed.

d. On August 26, 2005, KPMG entered into a deferred prosecution agreement with the United States Department of Justice. In the agreement, KPMG admitted (among other things) that

> [t]he FLIP and OPIS opinions signed by KPMG tax partners, and the representations drafted by KPMG tax partners and knowingly adopted by the high net worth individual clients,

> falsely stated that: (a) the client requested KPMG's opinion "regarding the U.S. federal income tax consequences of certain investment portfolio transactions," when in truth and in fact these were tax shelter transactions designed to generate bogus tax losses; (b) the "investment strategy" was based on the expectation that a leveraged position in the foreign bank securities would provide the "investor" with the opportunity for capital appreciation, when in truth and in fact the strategy was based on the expected bogus tax benefits to be generated; and (c) certain money was paid as part of an investment (i.e., for a warrant or a swap), when in truth and in fact the money constituted fees due to promoters and other facilitators of the transaction. All of these opinion letters were substantially identical, save for the names of the clients and entities involved, the dates, and the dollar amounts involved in the transactions.

KPMG further admitted that KPMG partners

> actively took steps to conceal these shelters from the IRS. These actions included . . . deciding not to register the tax shelters with the IRS, as required by law. . . . [¶] As part of their efforts to conceal the tax shelters from the IRS, KPMG tax leaders decided not to register those tax shelters as KPMG was required by law to do. Specifically, the decisions not to register the tax shelters were made in the face of advice from its professional and legal compliance personnel that the shelters should have been registered.

KPMG agreed to pay the United States a total of $465 million in disgorgement of fees, restitution to the IRS, and IRS penalties, and agreed to limitations on its practice, including a prohibition against prepackaged tax products and providing tax services under conditions of confidentiality.[6]

e. In *Blum v. Commissioner*, T.C. Memo 2012-16, filed January 17, 2012, the United States Tax Court held that an OPIS transaction lacked economic substance and disallowed the claimed losses of $45 million. Blum, the founder of buy.com, had sold a minority interest in the company for $45 million. He then invested $6 million into an OPIS transaction that generated an actual loss of $1.5 million, but the Blums claimed over $45 million in capital losses from the transaction. The tax court found that KPMG had

> painstakingly structured an elaborate transaction with extensive citations to complex Federal tax provisions. The entire series of

[6] On January 9, 2008, in Case No. AC-2006-028, the board took disciplinary action against KPMG's California Partnership Registration.

> steps, however, was a subterfuge to orchestrate a capital loss. A taxpayer may not deduct losses resulting from a transaction that lacks economic substance, even if that transaction complies with the literal terms of the [Internal Revenue] Code.
>
> [¶] . . . [¶]
>
> . . . Petitioners incurred no such economic loss of the stated magnitude. Indeed, petitioners do not contest that their loss is fictional. The absence of economic reality is the hallmark of a transaction lacking in economic substance. [Citations omitted.]

(*Id.* at pp. 27, 34.)

29. McCaffery's opinion on the validity of FLIP and OPIS losses is not persuasive.

30. Debra S. Petersen is a retained expert for complainant. Petersen is a licensed California certified public accountant and attorney. She has worked in the tax departments of two Big Eight accounting firms, and also as staff counsel for the Franchise Tax Board. Petersen is now in private practice as a tax attorney, and she is a tax professor at the McGeorge School of Law. In Petersen's opinion, the tax losses attributable to FLIP and OPIS transactions are not valid. Her opinion, supported by the events described in Finding 28, above, is persuasive.

BLIPS

31. After leaving KPMG, respondent became the chief financial officer of Pacific Capital Group, a private investment firm owned by Gary Winnick. Winnick had been a client of respondent's at KPMG, where he had entered into a FLIP transaction.

32. After respondent left KPMG, the firm developed a new product called Bond Linked Issue Premium Structure, or "BLIPS." Respondent was not involved in the development or sale of BLIPS when he was at KPMG, and he was not a party to any internal KPMG communications about the product.

33. Respondent was given a presentation on BLIPS by KPMG tax partner Randy Bickham. The details of that presentation were not established by the evidence, other than that BLIPS was marketed as a "[m]ulti-stage strategy designed by Presidio Advisors to generate significant investment returns through strategic investments in emerging market currencies." Unlike the case with FLIP and OPIS, the evidence does not include KPMG's full explanation to its salespersons on the product.

34. After discussing the product with Bickham, respondent had many conversations with Amir Makov, an investment advisor at Presidio Advisors, about the

BLIPS strategy. Respondent testified that he was impressed with Makov's academic credentials (Harvard), and his business experience (former trader at Goldman Sachs). Respondent found that Makov was knowledgeable about "directional bets on foreign currency," which is how respondent states that he viewed BLIPS.

35. On September 24, 1999, respondent, on behalf of one of Winnick's companies, GKW Unified Holdings (GKW), signed an engagement letter with KPMG for a BLIPS transaction. GKW agreed to pay KPMG $3,000,000 as its fee for the BLIPS transaction. KPMG provided GKW with a more-likely-than-not opinion letter. GKW exited from the BLIPS strategy in December 1999.

36. Also on September 24, 1999, respondent, using his own company, "Fiducia," signed an engagement letter with KPMG for a BLIPS transaction on his own account. Respondent agreed to pay KPMG $50,000 as his fee for the BLIPS transaction. KPMG provided respondent with a more-likely-than-not opinion letter. Respondent exited from the BLIPS strategy in December 1999. According to respondent, he left the strategy not to generate losses, but because the investment results did not meet his expectations. No contrary evidence was presented.

37. GKW claimed losses from the BLIPS transactions on its 1999 federal tax return, and Fiducia claimed losses from the transaction on its 1999, and possibly on its 2000, federal tax returns. The amount of the losses that GKW and Fiducia claimed was not established by the evidence. In closing argument, complainant asserts that respondent claimed $3,000,000 in losses on his tax return for the year 2000, but the evidence complainant relies on to support this assertion is hearsay, and is therefore insufficient to support a finding on the issue.

38. The amended accusation alleges that

> [r]espondent reviewed, and approved at least two BLIPS opinion letters and related documents . . . although he knew or should have known that (i) the tax positions taken were not "more likely than not" to prevail against an IRS challenge if the true facts were known to the IRS, and (ii) the opinion letters and other documents used to implement BLIPS were false and fraudulent in a number of ways, including but not limited to the following:
>
> a. BLIPS was falsely described as a three-stage, seven-year program, when in truth . . . all participants were expected to withdraw at the earliest opportunity and within the same tax year in order to obtain their tax losses. BLIPS was falsely described as a "leveraged" investment program . . . .

> b. The BLIPS opinion letters falsely stated that the client "believed there was a reasonable opportunity to earn a reasonable pre-tax profit from the . . . transactions," when in truth . . . there was no "reasonable likelihood of earning a reasonable pre-tax profit" . . . .
>
> c. The opinion letters and other documents were misleading in that they were drafted to create the false impression that KPMG, its tax personnel, and others associated with the tax shelter scheme were all independent service providers and advisors, when in truth . . . KPMG personnel and associates jointly developed and marketed the BLIPS shelter.

39. While subsequent events demonstrated that the BLIPS opinion letters and the BLIPS documentation were false or fraudulent in numerous respects, the evidence fails to establish that respondent knew the documents were false or fraudulent, or believed they were false or fraudulent, when he entered into the BLIPS transactions in September 1999. Unlike FLIP and OPIS, respondent had no role in the development or implementation of BLIPS; his only connection with BLIPS was as a client. The evidence does not establish the details of how BLIPS was described to respondent by Bickham or Makov. Contrary to the allegations in the amended accusation, respondent did not sign or approve any BLIPS opinion letters.

40. Complainant argues that respondent should have known the transactions were false or fraudulent because GKW's fees for its BLIPS transaction were $3,000,000, while Fiducia's fees for the same basic transaction were $50,000. This argument is based on complainant's assertion that GKW's losses were many times greater than respondent's. The evidence, however, does not establish the amount of the losses claimed by Fiducia or GKW, nor does it establish the relative amounts of their claimed losses.

41. Complainant argues that respondent should have known the transactions were false or fraudulent because BLIPS was an "abusive transaction." Complainant uses the term "abusive transaction" to refer to a transaction that would not be upheld by the IRS if all the facts were known.

There is no question but that, after respondent entered into BLIPS transactions, BLIPS was determined to be an abusive tax shelter. In Notice 2000-44, published on September 5, 2000, the IRS identified BLIPS-type strategies as listed transactions. In 2004, the IRS offered a settlement initiative to taxpayers who had participated in BLIPS transactions. Under the terms of the initiative, the taxpayer had to concede 100 percent of the claimed tax losses, in return for reduced penalties. Almost 75 percent of BLIPS transactions, including GKW and respondent, participated in the settlement initiative. And in *Klamath Strategic Investment Fund ex rel. St. Croix Ventures v. United States* (5th Cir. 2009) 568 F.3d 537, the court held that the loan transactions in a BLIPS strategy lacked economic substance and disregarded them for tax purposes.

Other evidence supports the conclusions of the IRS and the court's *Klamath* decision. In the deferred prosecution agreement it entered into in 2005, KPMG admitted that its BLIPS opinions and documents contained false and fraudulent representations. And, in 2007, Makov pled guilty to federal criminal charges in connection with his role in BLIPS and admitted that the transactions were fraudulent.

These later developments, however, are not sufficient in themselves to establish that respondent should have known BLIPS was an abusive transaction in September 1999. Complainant points to a provision in KPMG's deferred prosecution agreement, in which KPMG states that the false representations in a BLIPS transaction "were devised by KPMG tax partners and others involved in designing BLIPS and were knowingly adopted by the high net worth individual clients." KPMG's hearsay statement concerning respondent's state of mind is not sufficient to support a finding that respondent knew the representations were false when he entered into transactions. Complainant argues that respondent should have known the transactions were abusive before he filed his 1999 tax returns in October 2000, because the IRS identified BLIPS as a listed transaction in September 2000. The allegations in the amended accusation, however, do not relate to respondent's knowledge at the time he filed his 1999 income tax return, but to the time he entered into BLIPS transactions in September 1999.

IRS audit of GKW

42. In 2002, GKW was audited and respondent was the contact person with the IRS on behalf of GKW. After the audit resolved in April 2002, GKW entered into a closing agreement with the IRS with respect to its 1999 and 2000 returns. On February 24, 2003, the IRS informed GKW that it proposed to set aside the closing agreement on the ground (among others) that respondent "may not have provided accurate information during the drafting of the closing agreement." Respondent contested the proposed reopening. Ultimately, the IRS did not reopen the closing agreement.

43. The amended accusation alleges that the IRS entered into a closing agreement with GKW "only to later consider setting it aside because Respondent, the representative of GKW Unified Holdings, LLC, provided inaccurate statements and misrepresentations to the IRS." It is true that the IRS considered setting aside the closing agreement on those grounds. The evidence presented in this hearing, however, does not establish that the IRS ultimately found that respondent provided inaccurate statements and misrepresentations, or that respondent did in fact provide inaccurate statements and misrepresentations.

Other matters

44. Michael Davis is a licensed California CPA and attorney. Davis joined KPMG in February 1976 and retired from the firm as a partner in September 2008. Davis recruited respondent to work at KPMG when respondent was an undergraduate, and then trained him and supervised him for four or five years; they have remained friends. Davis testified that respondent enjoyed a very good reputation in the firm, that he was intelligent,

and that he did "interesting work." Davis cannot believe that respondent committed lies or fraud, and he does not believe it. Davis does not have any personal knowledge of respondent's role in the development, implementation or sale of FLIP or OPIS.

45. Respondent submitted letters from over 25 friends, clients, professional associates, and associates from his religious and charitable endeavors. The authors praise respondent for his honesty, integrity, competence, professionalism, and generosity. None of the letters addresses respondent's participation in FLIP or OPIS.

46. At the conclusion of the hearing, complainant withdrew the allegations that respondent prepared tax returns that "fraudulently concealed . . . bogus losses from the IRS . . . using a device called 'grantor trust netting,'" and that he "sold the grantor trust netting concept to a client who decided not to amend his return."

Costs

47. The Supervising Deputy Attorney General assigned to this case certifies, in a declaration dated July 7, 2011, that the Department of Justice has billed the board $100,954.75 for attorney services through June 29, 2011. The general tasks performed, the time spent on each task and the method of calculating the costs are set forth in an itemized billing statement.

48. In the same declaration, the Supervising Deputy Attorney General estimates that an additional 60 hours of attorney time in the amount of $10,200, and an additional 20 hours of paralegal time in the amount of $2,400, "were or will be incurred and billed to the [board] for the further preparation of the case up to the commencement of the hearing." There is no description of the tasks to be undertaken or the time to be spent on the tasks associated with this estimate.

49. In a declaration dated July 7, 2011, complainant states that the board's investigative certified public accountant spent nine hours on this case for a total cost of $1,136.61.

50. Complainant also states that the board has incurred costs of $101,479.75 for the services of the Attorney General's office through June 30, 2011. Complainant's statement of Attorney General costs, which exceeds the costs identified by the Supervising Deputy Attorney General by $525, is not supported by an itemized billing statement. No evidence was offered to reconcile the two statements.

51. Complainant also states that the board has incurred costs of $74,208.65 for the services of "Special Matters Expert(s)." There is no declaration from the person or persons who provided this service, describing the general tasks performed, the time spent on each task, or the hourly rate or other compensation for the service, nor did the agency attach copies of the time and billing records submitted by the service provider.

LEGAL CONCLUSIONS

Standard of proof

1. The standard of proof applied in making the factual findings set forth above is clear and convincing evidence to a reasonable certainty.

Laches

2. Respondent moves to dismiss the accusation on the ground that it is barred by the doctrine of laches. It is respondent's burden to prove that there was unreasonable preaccusation delay that prejudiced his ability to prepare a defense. (*Miller v. Eisenhower Med. Ctr.* (1980) 27 Cal.3d 614, 624; *Gates v. Department of Motor Vehicles* (1979) 94 Cal.App.3d 921, 925.)

The accusation in this case was issued on November 17, 2009. Respondent argues that facts concerning the matters alleged in the accusation

> were made public at least as early as November 2003, when the Senate held Congressional hearings on the matter. The Senate then issued an extensive report on its findings in February 2005. Federal prosecutors filed criminal charges in Fall 2005, and the charges against [respondent] were dismissed in July 2007. Yet the Board of Accountancy did not file any accusation until two years later and more than nine years after the conduct that is the subject of the accusation.

Evidence was not presented to support the claim that the matters alleged in the accusation became public in 2003. The Senate report was excluded upon respondent's objection. The published case of *United States v. Stein* (S.D.N.Y. 2007) 495 F.Supp.2d 390, supports respondent's claim that criminal charges against him were dismissed in 2007, but the evidence does not establish that preaccusation delay from 2007 to 2009 was unreasonable.

On the issue of prejudice, respondent argues that prior to the dismissal of the indictment against him in 2007 there were over 22 million pages of discovery arising out of various investigations, audits, and civil and criminal court proceedings. After the indictment against him was dismissed, respondent argues, his attorneys destroyed the vast majority of the documents. Respondent asserts that the missing documents included transactional documents that would have "demonstrated the bona fides of the underlying investments that formed the basis for" FLIP, OPIS and BLIPS. The point is moot with respect to BLIPS. (Findings 39-41.) Transaction documents for FLIP were admitted into evidence; since all FLIP transactions were essentially the same, more transaction documents would have been of little probative value. Respondent did not sell any OPIS transactions. OPIS transaction documents would have been of little probative value light of the evidence that respondent knew the transactions were not valid under the tax laws.

The evidence does not establish that there was unreasonable preaccusation delay. Assuming for the sake of argument that there was, the delay did not prejudice respondent in preparing his defense. Respondent's motion to dismiss the accusation is denied.

First Cause for Discipline (fraud)

3. Under Business and Professions Code section 5100, subdivision (c), the board may take disciplinary action against a certified public accountant who commits fraud in the practice of accounting. Cause exists to take disciplinary action against respondent's license by reason of the matters set forth in Findings 12-14, 18, 20-26.

4. Respondent argues that a showing of fraud requires proof of damages. While proof of damages may be required in a civil action, it is not required in a professional licensing proceeding, where the purpose is to protect the public, not to compensate the victim. (*Kearl v. Board of Medical Quality Assurance* (1986) 189 Cal.App.3d 1040, 1053.)

5. In closing argument, complainant argues that respondent engaged in numerous instances of fraudulent conduct that are not alleged in the amended accusation. Complainant asserts, for example, that respondent backdated opinion letters; that he signed opinions without having received representation letters; that he failed to discuss or inadequately discussed certain points in the opinions; and that he committed tax evasion with respect to his own tax returns and the tax returns of GKW. Government Code section 11503 states, in pertinent part, that an accusation must "set forth in ordinary and concise language the acts or omissions with which the respondent is charged, to the end that the respondent will be able to prepare his defense." Respondent's license cannot be disciplined for acts or omissions that were not alleged.

Second Cause for Discipline (dishonesty)

6. Under Business and Professions Code section 5100, subdivision (c), the board can take disciplinary action against an accountant who engages in dishonesty in the practice of public accounting. Cause exists to take disciplinary action against respondent's certificate by reason of the matters set forth in Findings 12-14, 18, 20-26.

Third Cause for Discipline (gross negligence)

7. Under Business and Professions Code section 5100, subdivision (c), the board can take disciplinary action against an accountant for gross negligence in the practice of public accounting.

8. Complainant argues that any acts of fraud or dishonesty are "also gross negligence, because committing fraud and dishonesty in the practice of public accountancy is an extreme departure from the standard of care." No authority is offered for this proposition, which is not persuasive.

9. Complainant argues that respondent was grossly negligent for failing to "completely and adequately research and review the positions taken in the opinion letters he signed." With the exception of BLIPS, however, the amended accusation alleges that any inaccurate positions respondent took were intentional, not grossly negligent. The evidence does not establish that respondent's participation in BLIPS was grossly negligent. (Findings 40-42.)

10. Complainant argues that "[r]espondent's refusal to take responsibility for his conduct, especially his failure to take ownership for the content of his opinion letters, amounts to gross negligence." The amended accusation does not allege any such facts.

11. Cause does not exist to take disciplinary action against respondent's license for gross negligence.

Fourth Cause for Discipline (violation of professional standards)

12. Under Business and Professions Code section 5100, subdivision (g), the board can take disciplinary action against an accountant for "willful violation of . . . any rule or regulation promulgated by the board . . . ." Board rule 58 requires accountants to comply with "all applicable professional standards."

13. The professional standards applicable to certified public accountants who prepare federal tax returns or give federal tax advice for compensation are set forth in part 10 of title 31 of the Code of Federal Regulations. These regulations are commonly referred to as "Circular 230."

Section 10.30 provides, in relevant part, that a practitioner "may not, with respect to any Internal Revenue Service matter, in any way use or participate in the use of any form of public communication or private solicitation containing a false, fraudulent, or coercive statement or claim; or a misleading or deceptive statement of claim."

Respondent violated this regulation by reason of the matters set forth in Findings 13, 14, 24 and 26.

14. The American Institute of Certified Public Accountants has established a Code of Professional Conduct.

Rule 102 states, in pertinent part, that "In the performance of any professional service, a member shall maintain objectivity and integrity, . . . and shall not knowingly misrepresent facts . . . ." Rule 501 states that "[a] member shall not commit an act discreditable to the profession." Respondent violated these regulations by reason of the matters set forth in Findings 12-14, 18, 20-26.

15. Cause exists under Business and Professions Code section 5100, subdivision (g), and board rule 58, to take disciplinary action against respondent's license by reason of the matters set forth in Legal Conclusions 13 and 14.

16. The amended accusation recites other professional rules and regulations that apply to certified public accountants, including rules and regulations pertaining to the preparation of tax returns, due diligence, and negligence. The evidence fails to establish any violations of regulations other than those set forth in Legal Conclusion 15.

Fifth Cause for Discipline (conspiracy with nonlicensees)

17. Business and Professions Code section 125 provides, in relevant part, that it is cause for discipline against any licensee to conspire with a nonlicensee to violate any provision of the Business and Professions Code. The evidence establishes that respondent worked with individuals outside of KPMG in his efforts to implement and sell FLIP transactions, and to develop OPIS. It is complainant's burden, however, to establish that those individuals were not licensed by the board, and no evidence on that subject was offered. Cause does not exist under Business and Professions Code section 125 to take disciplinary action against respondent's license for conspiracy with nonlicensees.

Sixth Cause for Discipline (repeated negligent acts)

18. Business and Professions Code section 5100, subdivision (c), provides that disciplinary action can be taken against an accountant who engages in repeated negligent acts. As was the case with the third cause for discipline, complainant argues that fraudulent or dishonest conduct "amount[s] to repeated acts of negligence." Again, complainant offers no authority for this position, and it is rejected. Cause does not exist to take disciplinary action against respondent's license for repeated negligent acts.

Seventh Cause for Discipline (breach of fiduciary duty)

19. Business and Professions Code section 5100, subdivision (i), provides that disciplinary action can be taken against an accountant who breaches any fiduciary responsibility.

Complainant acknowledges that California certified public accountants are not fiduciaries as a matter of law.[7] Nevertheless, the facts of a particular case may establish that

[7] Despite this acknowledgement, complaint cites *Electronic Equipment Express, Inc. v. Donald H. Seiler & Co.* (1981) 122 Cal.App.3d 834, for the proposition that "[s]tate-licensed professionals, including accountants, owe fiduciary duties to their clients with respect to the professional service performed." The case does not stand for that proposition.

a fiduciary or confidential relationship exists.[8] In both cases, fiduciary and confidential relationships, the "essence of [the] relationship is that the parties do not deal on equal terms, because the person in whom trust and confidence is reposed and who accepts that trust and confidence is in a superior position to exert unique influence over the dependent party." (*Barbara A. v. John G.* (1983) 145 Cal.App.3d 369, 382.) The courts have identified four essential elements that must be satisfied to establish the existence of a fiduciary or confidential relationship:

> "1) The vulnerability of one party to the other which 2) results in the empowerment of the stronger party by the weaker which 3) empowerment has been solicited or accepted by the stronger party and 4) prevents the weaker party from effectively protecting itself."

(*Richelle L. v. Roman Catholic Archbishop* (2003) 106 Cal.App.4th 257, 272, quoting from *Langford v. Roman Catholic Diocese of Brooklyn* (1998) 177 Misc.2d 897, 900.)

Respondent did not have any OPIS clients, and no wrongdoing was established with respect to the BLIPS transaction he entered into on behalf of GKW. If there was a breach of fiduciary duty, it must have been with respect to his FLIP clients. On its face, the relationship does not appear to have been equal, given the expertise of KPMG and the complexity of the transaction. There is, however, no evidence that respondent's FLIP clients were vulnerable. On the contrary: respondent's FLIP clients were wealthy, financially sophisticated individuals seeking millions of dollars in tax losses, losses far in excess of any money they put at risk. In addition, respondent's FLIP clients had the ability to protect themselves with independent legal and financial advice, and some did so. The evidence fails to establish that a fiduciary or confidential relationship existed between respondent and his FLIP clients.

Cause does not exist to take disciplinary action against respondent's license for breach of fiduciary duty.

Eighth Cause for Discipline (*knowing preparation of false information*)

20. Business and Professions Code section 5100, subdivision (j), provides, in relevant part, that disciplinary action can be taken against an accountant for "knowing preparation, publication or dissemination of false, fraudulent, or materially misleading . . . information." Cause exists to take disciplinary action against respondent's license by reason of the matters set forth in Findings 13, 14, 24 and 26.

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[8] California decisions hold that a "confidential" relationship may exist where a "fiduciary" relationship does not, and that both types of relationship create a fiduciary duty "'to act with utmost good faith for the benefit of the other party.'" (*Persson v. Smart Inventions, Inc.* (2005) 125 Cal.App.4th 1141, 1160.)

Ninth Cause for Discipline (obtaining consideration by false pretenses)

21. Business and Professions Code section 5100, subdivision (k), provides, in relevant part, that disciplinary action can be taken against an accountant for obtaining valuable consideration by false pretenses. Cause exists to take disciplinary action against respondent's license by reason of the matters set forth in Findings 3, 13, 14, 24 and 26.

Tenth Cause for Discipline (violation of professional standards)

22. Complainant acknowledges that the tenth cause for discipline realleges the fourth cause for discipline.

Cost recovery

23. Business and Professions Code section 125.3 provides that a licentiate found to have violated the licensing laws may be ordered to pay a sum not to exceed the reasonable costs of the investigation and enforcement of the case.

24. An agency that seeks to recover its costs must submit declarations "that contain specific and sufficient facts to support findings regarding actual costs incurred and the reasonableness of the costs . . . ." (Cal. Code Regs., tit. 1, § 1042, subd. (b).) For services provided by persons who are not agency employees, the declaration "shall be executed by the person providing the service and describe the general tasks performed, the time spent on each task and the hourly rate or other compensation for the service. In lieu of this Declaration, the agency may attach to its Declaration copies of the time and billing records submitted by the service provider."

25. Complainant's statement of the board's costs for Attorney General services, $101,479.75, is not supported by itemized billing statements. (Finding 50.) According to the declaration of the Supervising Deputy Attorney General who tried the case, which is supported by billing statements, the Attorney General's office has billed the board $100,954.75 for its services. (Finding 48.) The evidence establishes that the board has incurred costs of $100,954.75 for Attorney General services.

26. Complainant's statement of costs includes $74,208.65 for "special matter expert(s)." These costs are not supported by a declaration that complies with section 1042, or by billing records. (Finding 51.) The evidence is not sufficient to establish the actual costs incurred or the reasonableness of the costs. These costs are not recoverable under Business and Professions Code section 125.3.

27. The cost declaration of the Supervising Deputy Attorney General seeks recovery of $12,600 in "estimated costs." These estimated costs are not supported by a declaration that complies with section 1042. (Finding 48.) The evidence is not sufficient to establish the actual costs incurred or the reasonableness of the costs. These costs are not recoverable under Business and Professions Code section 125.3.

28. Complainant has incurred $102,091.36 in actual costs in connection with the investigation and enforcement of this matter, as follows:

Board's investigative CPA:	$1,136.61
Attorney General costs:	100,954.75
Total:	$102,091.36

(Findings 47 & 49.) In the absence of any evidence to the contrary, these costs are determined to be reasonable.

29. The case of *Zuckerman v. Board of Chiropractic Examiners* (2002) 29 Cal.4th 32 sets forth certain standards by which a licensing board must exercise its discretion to reduce or eliminate cost awards to ensure that licensees with potentially meritorious claims are not deterred from exercising their right to an administrative hearing. Those standards include whether the licensee has been successful at hearing in getting the charges dismissed or reduced, the licensee's good faith belief in the merits of his position, whether the licensee has raised a colorable challenge to the proposed discipline, the financial ability of the licensee to pay, and whether the scope of the investigation was appropriate to the alleged misconduct.

Respondent was successful in defending the allegations relating to fraud in connection with BLIPS transactions; to gross negligence; to conspiracy with unlicensed persons; to repeated acts of negligence; and to breach of fiduciary duty. He was also successful in defending the allegations with respect to the closing agreement between GKW and the IRS. And he was successful in persuading complainant to withdraw allegations that he fraudulently concealed bogus losses from the IRS through grantor trust netting. The board's actual costs in investigating these allegations are not known, but a reasonable estimate is 20 percent of the board's total costs. The board's total cost recovery is reduced by 20 percent, from $102,091.36 to $81,673.09 ($102,091.36 - $20,418.27 = $81,673.09).

30. The board's recoverable costs of investigation and enforcement are $81,673.09.

Disciplinary considerations

31. Respondent has no history of prior discipline, and it has been almost 14 years since FLIP and OPIS were marketed by KPMG. It is acknowledged that respondent did not conceive these products; they were the result of the concerted, dishonest intellectual effort of sophisticated tax and investment specialists inside and outside of KPMG. Respondent, however, headed KPMG's nationwide effort to implement FLIP; he signed FLIP opinions and sold FLIP transactions; he headed the firm's nationwide effort to bring OPIS to market; and he took steps to conceal the true nature of the transactions from the IRS. Respondent did these things knowing that the losses claimed by FLIP and OPIS clients were not proper. His conduct with respect to FLIP and OPIS demonstrated a lack of integrity in the practice of public accounting. Despite the passage of time, there is no meaningful evidence of

rehabilitation. Respondent has not practiced public accounting since he left KPMG. While respondent's character references vouch for his honesty, they appear to be unaware of his role in FLIP and OPIS. Respondent himself denies any wrongdoing. His lack of candor at hearing, and his unpersuasive testimony that he believed at all times in the validity of FLIP and OPIS, raise fresh concerns about his honesty. It would be contrary to the public interest to allow respondent to retain his certified public accountant license.

Administrative penalty

32. The amended accusation seeks imposition of an administrative penalty pursuant to Business and Professions Code section 5116.2. That section authorizes the board to assess an administrative penalty, not to exceed $50,000 for the first violation, against an individual who has violated subdivisions (c), (j) or (k) of Business and Professions Code section 5100.

The board's guidelines set forth 14 factors to be considered in the assessment of penalties. Most of the factors are the same as those that must be applied to determine the level of discipline to be imposed in a particular case. With respect to the imposition of a penalty, however, one of the issues to be considered is "the level of . . . penalty necessary to deter future violations." No evidence on this issue was offered. Complainant's closing briefs offer no guidance on the imposition of a penalty; they address the level of discipline sought by complainant, but are silent on the issue of a penalty. It has long been held that the purpose of license discipline is to protect the public, not to punish the licensee. (*Hughes v. Board of Architectural Examiners* (1998) 17 Cal.4th 763, 785.) While the board has the undoubted authority to impose a penalty in the proper case, the issue is sufficiently unusual that evidence, or at the very least argument, should have been presented if the board intended to pursue this claim. Since none was offered, it is concluded that complainant's prayer for an administrative penalty has been abandoned.

ORDER

1. Certified Public Accountant Number CPA 31490 issued to respondent Gregg Wayne Ritchie is revoked.

2. Respondent shall reimburse the board $81,673.09 for its costs of investigation and enforcement. Payment shall be made to the board within 30 days of the date the board's decision is final.

DATED: March 16, 2012

DAVID L. BENJAMIN
Administrative Law Judge
Office of Administrative Hearings

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BEFORE THE
CALIFORNIA BOARD OF ACCOUNTANCY
DEPARTMENT OF CONSUMER AFFAIRS
STATE OF CALIFORNIA

In the Matter of the Accusation Against: **GREGG WAYNE RITCHIE** **9355 Wilshire Blvd., 4th Floor** **Beverly Hills, CA 90210** **Certified Public Accountant** **Certificate No. CPA 31490** Respondent.	Case No. AC-2010-10 **AMENDED ACCUSATION**

Complainant alleges:

PARTIES

1. Patti Bowers (Complainant) brings this Amended Accusation solely in her official capacity as the Executive Officer of the California Board of Accountancy, Department of Consumer Affairs.

2. On or about January 30, 1981, the California Board of Accountancy issued Certified Public Accountant Number CPA 31490 to Gregg Wayne Ritchie (Respondent). The Certified Public Accountant Certificate was in full force and effect at all times relevant to the charges brought in this Amended Accusation and expires on February 28, 2011, unless renewed.

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JURISDICTION

3. This Amended Accusation is brought before the California Board of Accountancy (Board), Department of Consumer Affairs. under the authority of Section 5100 of the Business and Professions Code, which provides, in relevant part, that, after notice and hearing, the Board may revoke, suspend or refuse to renew any permit or certificate granted for unprofessional conduct which includes, but is not limited to, one or any combination of the causes specified therein, including willful violations of the Accountancy Act and willful violations of rules and regulations promulgated by the Board.

4. Business and Professions Code[1] Sections 118(b) and 5109 provide in pertinent part that the suspension, expiration, cancellation, or forfeiture of a license issued by the Board shall not deprive the Board of its authority to investigate, or to institute or continue a disciplinary proceeding against a licensee upon any ground provided by law, or to enter an order suspending or revoking the license or otherwise taking disciplinary action against the licensee on any such ground.

STATUTORY AND REGULATORY PROVISIONS

5. Section 5100 states:

"After notice and hearing the board may revoke, suspend, or refuse to renew any permit or certificate granted under Article 4 (commencing with Section 5070) and Article 5 (commencing with Section 5080), or may censure the holder of that permit or certificate for unprofessional conduct that includes, but is not limited to, one or any combination of the following causes:

. . .

"(c) Dishonesty, fraud, gross negligence, or repeated negligent acts committed in the same or different engagements, for the same or different clients, or any combination of engagements or clients, each resulting in a violation of applicable professional standards that

[1] All statutory references are to the Business and Professions Code unless otherwise indicated.

indicate a lack of competency in the practice of public accountancy or in the performance of the bookkeeping operations described in Section 5052."

. . .

"(g) Willful violation of this chapter or any rule or regulation promulgated by the board under the authority granted under this chapter."

. . .

"(i) Fiscal dishonesty or breach of fiduciary responsibility of any kind."

"(j) Knowing preparation, publication, or dissemination of false, fraudulent, or materially misleading financial statements, reports, or information."

"(k) Embezzlement, theft, misappropriation of funds or property, or obtaining money, property, or other valuable consideration by fraudulent means or false pretenses."

6. Licensees are required by Board Rule 5 to comply with all Board rules, including Board Rule 58, which provides that licensees engaged in the practice of public accountancy shall comply with all applicable professional standards.

7. Business and Professions Code section 125 provides, in pertinent part, that any licensee is guilty of a misdemeanor and subject to the disciplinary provisions of this code applicable to him, who conspires with a non-licensee to violate any provision of this code.

APPLICABLE PROFESSIONAL STANDARDS

8. Professional standards or standards of practice pertinent[2] to this Accusation include, without limitation:

A. Title 31, Part 10 of Internal Revenue Service (IRS) Regulations (31 CFR 10)[3] including:

(1) Section 10.21 (Knowledge of Client's Omission), provides that:

> "[a] practitioner who, having been retained by a client with respect to a matter administered by the Internal Revenue Service, knows that the client has not complied with the revenue laws of the United States or has made an error or

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[2] All references herein to standards and other authoritative literature are to the versions in effect at the time the shelters were being developed, marketed or sold.

[3] 31 CFR 10 is also referred to as "Circular 230" or Section 10 of the IRS Regulations. Among other things, Circular 230 governs practice by CPAs before the IRS.

omission from any return, document, affidavit, or other paper which the client submitted or executed under the revenue laws of the United States, must advise the client promptly of the fact of such noncompliance, error, or omission. The practitioner must advise the client of the consequences as provided under the Code and regulations of such noncompliance, error, or omission."

(2) Section 10.22(a) (Diligence as to Accuracy), provides that, in general, a practitioner must exercise due diligence:

"(1) In preparing or assisting in the preparation of, approving, and filing tax returns, documents, affidavits, and other papers relating to Internal Revenue Service matters;

(2) In determining the correctness of oral or written representations made by the practitioner to the Department of the Treasury; and

(3) In determining the correctness of oral or written representations made by the practitioner to clients with reference to any matter administered by the Internal Revenue Service."

(3) Section 10.30 (Solicitation), provides that a practitioner may not, with respect to any Internal Revenue Service matter, in any way use or participate in the use of any form or public communication or private solicitation containing a false, fraudulent, or coercive statement or claim; or a misleading or deceptive statement or claim.

(4) Section 10.34 (Standards for Advising with Respect to Tax Return Positions and for Preparing or Signing Returns), provides that a practitioner may not sign a tax return as a preparer if the practitioner determines that the tax return contains a position that does not have a realistic possibility of being sustained on its merits (the "realistic possibility standard") unless the position is not frivolous and is adequately disclosed to the Internal Revenue Service.

B. American Institute of Certified Public Accountants (AICPA) Code of Professional Conduct, which includes Section I - Principles and Section II - Rules. Both the Principles (Articles III and VI) and the Rules are relevant to the allegations herein.

(1) Rule 102 (Integrity and Objectivity), provides that:

"In the performance of any professional service, a member shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others."

(2) Rule 102.2 (Conflicts of Interest), provides that:

"A member shall be considered to have knowingly misrepresented facts in violation of rule 102. . . when he or she knowingly—

a. Makes, or permits or directs another to make, materially false and misleading entries in an entity's financial statements or records; or

b. Fails to correct an entity's financial statements or records that are materially false and misleading when he or she has the authority to record an entry; or

c. Signs, or permits or directs another to sign, a document containing materially false and misleading information."

(3) Rule 102-4 (Subordination of Judgment by a Member), provides that:

"Rule 102 [ET section 102.01] prohibits a member from knowingly misrepresenting facts or subordinating his or her judgment when performing professional services. Under this rule, if a member and his or her supervisor have a disagreement or dispute relating to the preparation of financial statements or the recording of transactions, the member should take the following steps to ensure that the situation does not constitute a subordination of judgment:

"1. The member should consider whether (a) the entry or the failure to record a transaction in the records, or (b) the financial statement presentation or the nature or omission of disclosure in the financial statements, as proposed by the supervisor, represents the use of an acceptable alternative and does not materially misrepresent the facts. If, after appropriate research or consultation, the member concludes that the matter has authoritative support and/or does not result in a material misrepresentation, the member need do nothing further.

2. If the member concludes that the financial statements or records could be materially misstated, the member should make his or her concerns known to the appropriate higher level(s) of management within the organization (for example, the supervisor's immediate superior, senior management, the audit committee or equivalent, the board of directors, the company's owners). The member should consider documenting his or her understanding of the facts, the accounting principles involved, the application of those principles to the facts, and the parties with whom these matters were discussed.

3. If, after discussing his or her concerns with the appropriate person(s) in the organization, the member concludes that appropriate action was not taken, he or she should consider his or her continuing relationship with the employer. The member also should consider any responsibility that may exist to communicate to third parties, such as regulatory authorities or the employer's (former employer's) external accountant. In this connection, the member may wish to consult with his or her legal counsel.

4. The member should at all times be cognizant of his or her obligations under interpretation 102-3 [ET section 102.04]."

(4) Rule 201 (General Standards), provides that:

"A member shall comply with the following standards and with any interpretations thereof by bodies designated by Council.

A. Professional Competence. Undertake only those professional services that the member or the member's firm can reasonably expect to be completed with professional competence.

B. Due Professional Care. Exercise due professional care in the performance of professional services.

C. Planning and Supervision. Adequately plan and supervise the performance of professional services.

D. Sufficient Relevant Data. Obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to any professional services performed."

(5) Rule 202 (Compliance With Standards), provides that:

"A member who performs auditing, review, compilation, management consulting, tax, or other professional services shall comply with standards promulgated by bodies designated by Council."

(6) Rule 501 (Acts discreditable), provides that:

"A member shall not commit an act discreditable to the profession."

(7) Rule 501-4 (Negligence in the Preparation of Financial Statements or Records), provides that:

"A member shall be considered to have committed an act discreditable to the profession in violation of rule 501 [ET section 501.01] when, by virtue of his or her negligence, such member:

a. Makes, or permits or directs another to make, materially false and misleading entries in the financial statements or records of an entity; or

b. Fails to correct an entity's financial statements that are materially false and misleading when the member has the authority to record an entry; or

c. Signs, or permits or directs another to sign, a document containing materially false and misleading information."

(8) Rule 502 (Advertising and Other Forms of Solicitation), provides that: "A member in public practice shall not seek to obtain clients by advertising or other forms of solicitation in a manner that is false, misleading, or deceptive. Solicitation by the use of coercion, over-reaching, or harassing conduct is prohibited."

(9) Rule 502-2 (False, Misleading or Deceptive Acts in Advertising or Solicitation), provides that:

"Advertising or other forms of solicitation that are false, misleading, or deceptive are not in the public interest and are prohibited. Such activities include those that—

1. Create false or unjustified expectations of favorable results.

2. Imply the ability to influence any court, tribunal, regulatory agency, or similar body or official.

3. Contain a representation that specific professional services in current or future periods will be performed for a stated fee, estimated fee or fee range when it was likely at the time of the representation that such fees would be substantially increased and the prospective client was not advised of that likelihood.

4. Contain any other representations that would be likely to cause a reasonable person to misunderstand or be deceived."

C. AICPA Statements on Standards for Tax Services[4], including:

(1.) TS Section 100 - Tax Return Positions.

(2.) TS Section 600 - Knowledge of Error: Return Preparation.

(3.) TS Section 800 - Form and Content of Advice to Tax Payers.

D. The Internal Revenue Code, including:

"(1) 26 U.S.C. §6111 (Section 6111), which governs the registration of tax shelters.

(2) 26 U.S.C. §6112 (Section 6112), which imposes certain obligations on the organizer or seller of a "potentially abusive tax shelter."

COST RECOVERY

9. Code Section 5107(a) provides, in pertinent part, that the Executive Officer of the Board may request the administrative law judge, as part of the proposed decision in a disciplinary proceeding, to direct any holder of a permit or certificate found to have committed a violation or violations of the Accountancy Act to pay to the Board all reasonable costs of investigation and prosecution of the case, including, but not limited to, attorneys' fees incurred prior to the commencement of the hearing. A certified copy of the actual costs, or a good faith estimate of costs signed by the Executive Officer, constitutes prima facie evidence of reasonable costs of investigation and prosecution of the case.

PUBLIC PROTECTION

10. Code Section 5000.1 provides, as follows: "Protection of the public shall be the highest priority for the California Board of Accountancy in exercising its licensing, regulatory, and disciplinary functions. Whenever the protection of the public is inconsistent with other interests sought to be promoted, the protection of the public shall be paramount."

FACTUAL BACKGROUND

11. The subject matter of this Amended Accusation is Respondent's participation in the development, marketing, and implementation of certain tax shelter schemes by himself and other

[4] The AICPA *Statements on Standards for Tax Services*, are codified as "TS" with section numbers, e.g., TS Section 100.

KPMG[5] personnel, including senior partners and members of top management, which assisted high net worth United States citizens to evade Unites States individual income taxes on billions of dollars in capital gain and ordinary income through the use of unregistered and fraudulent tax shelters.[6],[7]

12. Respondent was an employee of KPMG LLP[8] from at least in or about 1977 (when the company used the name Peat, Marwick, Mitchell & Company) through in or about September 30, 1998, working in the Los Angeles and Woodland Hills Offices. In 1987, Respondent became a partner. In 1997, he formed and was the head of KPMG's CaTS ("Capital Transaction Strategies") group. He formed this group around one of the very profitable tax shelter strategies, FLIP (discussed below). After FLIP was retired, he and some other KPMG partners formed another very profitable tax shelter strategy, OPIS (discussed below). Respondent left KPMG voluntarily on September 30, 1998, to work as chief financial officer of Pacific Capital Group (PCG). He became the liaison between KPMG and PCG.

[5] At all times relevant to this Accusation, KPMG was a limited liability partnership headquartered in New York, New York, with more than 90 offices nationwide, of which several are in California. Among the California KPMG offices during the time period relevant herein were offices in Los Angeles, Woodland Hills, San Diego, San Francisco, and Walnut Creek. KPMG was one of the largest auditing firms in the world, providing audit services to many of the largest corporations in the United States and elsewhere. KPMG also provided tax services to corporate and individual clients, some of whom were very wealthy. These tax services included, but were not limited to, preparing federal and state tax returns, providing tax planning and tax advice, and representing clients, for example, in Internal Revenue Service ("IRS") and Franchise Tax Board ("FTB") audits, and in Tax Court litigation with the IRS.

[6] The portion of KPMG's tax practice that specialized in providing tax advice to individuals, including wealthy individuals, was known as Personal Financial Planning, or "PFP." The KPMG group focused on designing, marketing, and implementing tax shelters for individual clients was known at different times as CaTS ("Capital Transaction Strategies"), and IS ("Innovative Strategies").

[7] KPMG personnel also formed alliances, operating agreements, and/or joint ventures with outside persons, including former partners, employees, and others. KPMG also worked with law firms/lawyers and with banks in implementing the FLIP, OPIS and BLIPS tax shelter transactions. Significant activity and coordination regarding the design and implementation of the tax shelters took place by California licensees or on behalf of California taxpayers.

[8] KPMG LLP ("KPMG") was, at all times relevant, licensed by the Board and operating several offices in California. KPMG was engaged in providing tax services to corporate and individual clients and providing audit services to corporate, governmental and other clients. The Board's related action against KPMG, Accusation No. AC-2006-28, was resolved effective January 18, 2008. It is further referenced in paragraph 13.

13. Board Case No. AC-2006-28, filed against KPMG, incorporated the Statement of Facts attached to the Deferred Prosecution Agreement ("DPA") which KPMG entered with the federal government, in or about August 26, 2005. In resolving Case No. AC-2006-28 with the Board, KPMG admitted and accepted that, as set forth in detail in the Statement of Facts attached to the DPA (which was incorporated into Accusation AC-2006-28),

> "through the conduct of certain KPMG tax leaders, partners, and employees, during the period from 1996 through 2002, KPMG assisted high net worth individuals to evade individual income taxes on billions of dollars by developing, promoting, and implementing unregistered and fraudulent tax shelters. A number of KPMG tax partners engaged in conduct that was unlawful and fraudulent...". (Accusation, Paragraph 57, quoting DPA.)[9]

A copy of the DPA agreement and Statement of Facts is attached as Exhibit A and is herein incorporated by reference.

14. Respondent was a tax partner at KPMG between 1987 and 1998, the period relevant herein. He participated in the above-described scheme, consisting of:

A. devising, marketing and implementing fraudulent tax shelters;

B. causing tax returns to be filed with the IRS that contained the fraudulent tax shelter losses; and

C. fraudulently concealing those shelters from the IRS.

FLIP, OPIS, and BLIPS TAX SHELTERS

15. The fraudulent tax shelter transactions which are the subject matter of this Accusation were FLIP ("Foreign Leveraged Investment Program"), OPIS ("Offshore Portfolio Investment Strategy"), and BLIPS ("Bond Linked Issue Premium Structure").[10]

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[9] See paragraphs 50-55 of Accusation AC-2006-28 and attachment, and paragraphs 9-11 of Stipulation AC-2006-28 for detail.

[10] During the relevant time period, KPMG personnel, some of its clients, and others involved in these tax shelter transactions prepared, signed and filed tax retuns that falsely and fraudulently claimed over $4.2 billion in bogus tax losses generated by FLIP and OPIS transactions, and $5.1 billion generated by BLIPS transactions. A significant proportion of the tax payers who filed tax returns with KPMG's assistance using FLIP, OPIS, and BLIPS tax shelters were California taxpayers. Approximately 29% of the transactions were in California and approximately 38% of KPMG's fees originated in California.

16. Respondent was highly involved in the creation and/or approval of the FLIP[11] and OPIS[12] transactions, and participated in the implementation of some BLIPS transactions.

17. The law in effect from at least in or about August 1997 provided that if a taxpayer claimed a tax benefit that was later disallowed, the IRS could impose substantial penalties, ranging from 20%-40% of the underpayment of tax attributable to the shelter, unless the tax benefit was supported by an independent opinion relied on by the taxpayer in good faith that the tax benefit was "more likely than not" to survive IRS challenge.

FLIP and OPIS SHELTERS

18. In most material respects, the FLIP and OPIS were the same. FLIP and OPIS were generally marketed only to people who had capital gains in excess of $10 million for FLIP and $20 million for OPIS.[13]

19. Respondent was highly involved in FLIP and OPIS transactions. As head of CaTS, Respondent was responsible for designing, marketing, and implementing tax shelters, including FLIP and OPIS for individual clients. The FLIP and OPIS opinion letters falsely asserted that tax positions taken were "more likely than not" to prevail against an IRS challenge if the true facts regarding those transactions were known to the IRS. All of these opinion letters were almost identical. Respondent gave the approvals for KPMG's tax professionals to market or continue to

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[11] FLIP was essentially similar to OPIS. The shelters were designed to generate bogus capital losses in excess of $20 million through the use of an entity created in the Cayman Islands. The client purportedly entered into an "investment" transaction with the Cayman Islands entity by purchasing a purported warrant or entering into a purported swap. The Cayman Islands entity purportedly made a pre-arranged series of investments, including the purchase, from a bank, of bank stock using money purportedly loaned by the bank, followed by a repurchase of that stock by the pertinent bank at a prearranged price. The tax shelter transactions were devised to last for only approximately 16 to approximately 60 days, and the duration of the shelter was pre-determined.

[12] OPIS was essentially similar to FLIP, described in the footnote above. KPMG's gross fees from OPIS transactions were at least $28 million.

[13] In return for fees totaling approximately 5-7% of the desired tax loss, including a fee to KPMG equal to approximately 1-1.25% of the desired tax loss, KPMG, its KPMG tax personnel and their associates implemented and caused to be implemented FLIP and OPIS transactions and generated and caused to be generated false and fraudulent documentation to support the transactions, including but not limited to KPMG opinion letters claiming that the purported tax losses generated by the shelters were "more likely than not" to withstand challenge by the IRS. As agreed to, and arranged by, KPMG tax personnel, outside lawyers also issued "more likely than not' opinion letters in return for fees typically of approximately $50,000 per opinion, which opinions tracked, sometimes verbatim, the KPMG opinion letter.

market the FLIP and OPIS transactions. The OPIS transactions were approved for sale in September 1998 in spite of a seven-page memorandum written to Respondent and other KPMG tax partners in February 1998, seven months earlier, filled with criticisms of the proposed tax product. The FLIP transactions were continued to be sold even after an e-mail written in March 1998 by one of KPMG's partners, a well respected technical advisor, Bob Simon, who identified a host of significant technical flaws in FLIP. On June 16, 1998, Respondent, along with another partner of KPMG, contacted Joseph J. Jacoboni and pressured Mr. Jacoboni to sign and return the KPMG Engagement Letter and the Representation Letter for the FLIP transaction that KPMG sold to Mr. Jacoboni. Respondent was identified to Mr. Jacoboni as the KPMG official responsible for producing the KPMG tax opinion regarding the FLIP transaction. The Representation Letter's statements were false and intentionally deceptive. Respondent told Mr. Jacoboni that KPMG would not release to Mr. Jacoboni any tax opinion regarding the FLIP transaction nor would KPMG prepare Mr. Jacoboni's 1997 income tax return until Mr. Jacoboni signed and returned the Representation Letter. Mr. Jacoboni reluctantly signed the Representation Letter and the Engagement Letter on July 30, 1998, and returned them to KPMG. Neither Respondent nor any other KPMG employee or partner delivered a tax opinion regarding the FLIP transaction to Mr. Jacoboni as promised in the Engagement Letter. KPMG prepared Mr. Jacoboni's tax return in the fall of 1998 and the tax return was filed with the IRS in October of 1998 claiming over $30 million of capital losses from the FLIP transaction. Moreover, Respondent was involved in the decision not to register the products as tax shelters with the IRS. Respondent signed at least five FLIP opinions, and, with the assistance of other KPMG tax personnel and their associates, issued and caused to be issued opinion letters although he knew, among other things, that (1) tax positions taken were not "more likely than not" to prevail against an IRS challenge if the true facts regarding those transactions were known to the IRS, and (2) that the opinion letters and other documents used to implement FLIP and OPIS were false and fraudulent in a number of ways, including, but not limited to the following:

a. Money was paid by the FLIP and OPIS clients for an "investment" component of the transactions (a warrant or a swap), whereas in fact that money constituted fees paid to

KPMG and other participants, as well as money that was temporarily "parked" in the deal but ultimately returned to the client.

b. There was no evidence of a "firm and fixed" plan to complete the steps making up the shelter in a particular manner when, in fact, there was such a plan, and the transactions in fact were designed to be completed, and were completed, in the particular manner designed to generate the tax loss.

c. The clients were not "more likely than not" to survive an IRS challenge (based on many problems including but not limited to, the "step transaction doctrine").[14]

BLIPS SHELTER

20. KPMG and its tax personnel and associates marketed and caused to be marketed, and implemented and caused to be implemented the BLIPS transaction, and generated and caused to be generated false and fraudulent documentation to support the BLIPS transactions.[15] This activity included, but was not limited to, generating KPMG opinion letters (and opinion letters by law firm(s)) that claimed that the purported tax losses generated by the shelters were more likely than not to withstand challenge by the IRS. All of these opinion letters were almost identical.

21. After he resigned from KPMG, Respondent was involved in implementing at least two BLIPS transactions, one for himself through the entity of Fiducia and at least one for his employer Gary Winnick, who owned and ran GKW Unified Holdings, LLC, and Pacific Capital Group, Inc. TMP (collectively GKW). Respondent, as the Managing Director and Chief Financial Officer of GKW, engaged KPMG LLP to provide tax consulting services with respect to BLIPS transactions for GKW. After GKW engaged in at least one BLIPS transaction through Townsbridge, and after Respondent assisted GKW in filing its tax returns, the IRS inquired into

[14] The "step transaction doctrine" is a legal doctrine permitting the IRS to disregard certain transactions having no economic substance or business purpose and the purported tax effects of those disregarded transactions.

[15] BLIPS generated at least $5.1 billion in bogus tax losses. KPMG's gross fees from BLIPS transactions were at least $53 million. Associated law firms and boutique practices had gross fees of at least $147 million. The fees totaled approximately 5-7% of the desired tax loss, including a fee to KPMG equal to approximately 1-1.25% of the desired tax loss, a fee to a "boutique practice" equal to approximately 2.75% of the desired tax loss, and a fee to a law firm generally equal to $50,000 per transaction.

GKW's 1999 and 2000 tax returns. The IRS interviewed Respondent on behalf of GKW, requested and received information from Respondent on behalf of GKW and entered into a "closing agreement" with GKW only to later consider setting it aside because Respondent, the representative of GKW Unified Holdings, LLC, provided inaccurate statements and misrepresentations to the IRS.

22. Respondent reviewed, and approved at least two BLIPS opinion letters and related documents (his own BLIPS transaction via Fiducia and GKW's BLIPS transaction via Townsbridge), although he knew or should have known that (i) the tax positions taken were not "more likely than not" to prevail against an IRS challenge if the true facts regarding those transactions were known to the IRS, and (ii) the opinion letters and other documents used to implement BLIPS were false and fraudulent in a number of ways, including but not limited to the following:

a. BLIPS was falsely described as a three-stage, seven-year investment program, when in truth and in fact, all participants were expected to withdraw at the earliest opportunity and within the same tax year in order to obtain their tax losses. BLIPS was falsely described as a "leveraged" investment program, whereas, in fact, the purported loan transactions that were part of BLIPS (and that were the aspect of BLIPS that purported to generate the tax loss) were shams -- no money ever left the bank and none of the banks assigned any capital cost to these purported BLIPS loans.

b. The BLIPS opinion letters falsely stated that the client (based on the client's purported "independent review," as well as that of outside "reviewers") "believed there was a reasonable opportunity to earn a reasonable pre-tax profit from the [BLIPS] transactions," when in truth and in fact, there was no "reasonable likelihood of earning a reasonable pre-tax profit" from BLIPS, and instead the "investment" component of BLIPS was negligible, unrelated to the large sham "loans" that were the key elements of the purported tax benefits of BLIPS, and was simply window dressing for the BLIPS tax shelter fraud.

c. The opinion letters and other documents were misleading in that they were drafted to create the false impression that KPMG, its tax personnel, and others associated with the tax shelter scheme were all independent service providers and advisors, when in truth and in fact KPMG personnel and associates jointly developed and marketed the BLIPS shelter.

FRAUDULENT CONCEALMENT OF TAX SHELTERS

23. In addition to preparing, causing to be prepared, and approving the false and fraudulent documentation relating to and implementing the shelter transactions, Respondent participated in steps taken to fraudulently conceal from the IRS the fraudulent tax shelters, and/or knew or should have known that the steps would have the effect of concealing the shelters from the IRS. The steps taken included, but were not limited to, the following:

(1) Not registering the tax shelters with the IRS as required by law. Notwithstanding his assumption that OPIS was a tax shelter, Respondent nonetheless recommended in an e-mail dated May 26, 1998 to his fellow partners that "KPMG should make the business/strategic decision not to register the OPIS product as a tax shelter."

(2) Preparing and causing to be prepared tax returns that fraudulently concealed the bogus losses from the IRS. For example, Respondent knew KPMG tax professionals were using a device called "grantor trust netting" to conceal the tax shelters from the IRS. Respondent was informed that the use of grantor trust netting on tax returns could be viewed as filing a false or misleading return. Respondent sold the grantor trust netting concept to a client who decided not to amend his tax return.

(3) Providing and causing to provide inaccurate statements and misrepresentations to the IRS.

FAILING TO REGISTER TAX SHELTERS

24. Under the law in effect at all times relevant to this Accusation, an organizer of a tax shelter was required to "register" the shelter by filing a form with the IRS describing the transaction. The IRS in turn would issue a number to the shelter, and all individuals or entities claiming a benefit from the shelter were required to include with their income tax returns a form disclosing that they had participated in a registered tax shelter, and disclosing the assigned registration number. Notwithstanding these legal requirements, KPMG's tax personnel, including Respondent, decided not to register the tax shelters based on a "business decision" that to register

the shelters would hamper KPMG's ability to sell them. Respondent knew or should have known of the requirement to register the shelters. In fact, Respondent recommended in an e-mail dated May 26, 1998 to his fellow partners that "KPMG should make the business/strategic decision not to register the OPIS product as a tax shelter" even though he assumed that OPIS was a tax shelter.

FIRST CAUSE FOR DISCIPLINE
Fraud in the Practice of Public Accountancy
[Business and Professions Code § 5100(c)]

25. The matters alleged in paragraphs 11 through 25 are re-alleged as though fully set forth.

26. Respondent's license is therefore subject to disciplinary action based on his direct involvement and acquiescence in:

A. The decision of KPMG not to register the tax shelters as required;

B. The preparation and approval of false or fraudulent documentation supporting the implementation of the tax shelters; and/or

C. Respondent's explicit and required approval of KPMG's marketing and implementation of the tax shelters including, but not limited to, Respondent's approval of allowing KPMG's personnel to sign the tax opinions and tax returns containing the fraudulent tax shelters.

27. Incorporating by reference the matters alleged in paragraphs 11-25, cause for discipline of Respondent's license for fraud in the practice of public accountancy is established under Code Section 5100(c).

SECOND CAUSE FOR DISCIPLINE
Dishonesty in the Practice of Public Accountancy
[Business and Professions Code § 5100(c)]

28. Complainant realleges paragraphs 11 through 25 above. Incorporating those matters by reference, cause for discipline of Respondent's license for dishonesty in the practice of public accountancy is established under Code Section 5100(c) based upon his dishonest acts, and omissions in the course of his participation, as described above, in the FLIP, BLIP, and OPIS tax shelters.

THIRD CAUSE FOR DISCIPLINE
Gross Negligence in the Performance of Public Accountancy
[Business and Professions Code § 5100(c)]

29. Complainant realleges paragraphs 11 through 25 above. Incorporating those matters by reference, cause for discipline of Respondent's license for gross negligence in the practice of public accountancy is established under Code Section 5100(c) based upon his conduct, which constituted extreme departures from applicable professional standards.

FOURTH CAUSE FOR DISCIPLINE
Failure to Observe Professional Standards in Performance of Public Accountancy
[Board Rule 58/ Business and Professions Code § 5100(g)]

30. Complainant realleges paragraphs 11 through 25. Incorporating those matters by reference, cause for discipline of Respondent's license is established in that his failure to comply with professional standards applicable to public accountancy constitutes the willful violation of Board Rule 58, providing cause for discipline of his license under Code Section 5100(g).

FIFTH CAUSE FOR DISCIPLINE
Conspiracy with Unlicensed Person to Violate Accountancy Act
[Business and Professions Code §§ 125, 5100]

31. Complainant realleges paragraphs 11 through 25. Incorporating those matters by reference, cause for discipline of Respondent's license is established in that he conspired with unlicensed persons, including lawyers and others, to devise, market, and/or implement the fraudulent tax shelters, in violation of Code section 125. The conduct of Respondent, as alleged, constitutes general unprofessional conduct under Code section 5100.

SIXTH CAUSE FOR DISCIPLINE
Repeated Negligent Acts in the Performance of Public Accountancy
[Business and Professions Code § 5100(c)]

32. Complainant realleges paragraphs 11 through 25 above. Incorporating those matters by reference, cause for discipline of Respondent's license for repeated negligent acts in the performance of public accountancy is established under Code Section 5100(c) based upon his conduct, which constituted repeated departures from applicable professional standards.

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SEVENTH CAUSE FOR DISCIPLINE

Breach of Fiduciary Responsibility in the Performance of Public Accountancy

[Business and Professions Code § 5100(i)]

33. Complainant realleges paragraphs 11 through 25 above. Incorporating those matters by reference, cause for discipline of Respondent's license for breach of fiduciary responsibility in the performance of public accountancy is established under Code Section 5100(i).

EIGHTH CAUSE FOR DISCIPLINE

Knowing Preparation, Publication, or Dissemination of False, Fraudulent or Materially Misleading Financial Statements, Reports, or Information

[Business and Professions Code § 5100(j)]

34. Complainant realleges paragraphs 11 through 25 above. Incorporating those matters by reference, cause for discipline of Respondent's license for knowing preparation, publication, or dissemination of false, fraudulent, or materially misleading financial statements, reports, or information is established under Code Section 5100(j).

NINTH CAUSE FOR DISCIPLINE

Obtaining Valuable Consideration by False Pretenses

[Business and Professions Code § 5100(k)]

35. Complainant realleges paragraphs 11 through 25 above. Incorporating those matters by reference, cause for discipline of Respondent's license for obtaining valuable consideration by false pretenses is established under Code Section 5100(k).

TENTH CAUSE FOR DISCIPLINE

Violation of Professional Standards

[Board Rule 58/ Business and Professions Code § 5100(g)]

36. Complainant realleges paragraphs 11 through 25 above. Incorporating those matters by reference, cause for discipline of Respondent's license for violation of professional standards is established under Board Rule 58 and Code Section 5100(g) based upon his conduct, including approving and causing to be signed, engagement and opinion letters for clients without independently, diligently or accurately evaluating the specific needs and concerns of the clients, which constitutes willful violation of Board Rule 58, providing cause for discipline of his license under Code section 5100(g).

PRAYER

WHEREFORE, Complainant requests that a hearing be held on the matters herein alleged, and that following the hearing, the California Board of Accountancy issue a decision:

1. Revoking, suspending or otherwise imposing discipline upon Certified Public Accountant Number 31490, issued to Gregg Wayne Ritchie.

2. Ordering Gregg Wayne Ritchie to pay the California Board of Accountancy the reasonable costs of the investigation and enforcement of this case, pursuant to Business and Professions Code section 5107;

3. Ordering Gregg Wayne Ritchie to pay the California Board of Accountancy an administrative penalty pursuant to Business and Profession Code section 5116.2;

4. Taking such other and further action as deemed necessary and proper.

Dated: June 9, 2011

Patti Bowers
PATTI BOWERS
Executive Officer
California Board of Accountancy

Complainant

SF2006400056